

**TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING 08-08**

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Whether the purchase of telecommunications services by an Internet service provider is subject to the Tennessee sales and use tax.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the department by the taxpayer. The rulings herein are binding upon the Department and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time.

Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (G) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[TAXPAYER] is an Internet service provider. The Taxpayer purchases telecommunication services from telecommunications companies in order to provide Internet access to end-user customers. The items purchased include digital subscriber line services (“DSL”), circuits, T1 lines, DS3 lines, *etc.* The Taxpayer paid sales tax on the purchase of these telecommunication services.

QUESTION

Is the purchase of telecommunications services by the Taxpayer, an Internet service provider, subject to the Tennessee sales and use tax?

RULING

No. Under the Federal Internet Tax Freedom Act, as amended by the Internet Tax Nondiscrimination Act of 2004 and the Internet Tax Freedom Act Amendments Act of 2007, the Taxpayer’s purchase of telecommunication services in conjunction with its provision of Internet access services is not subject to Tennessee sales and use tax.¹

ANALYSIS

The purchase of telecommunications services by the Taxpayer is not subject to the Tennessee sales and use tax because of the federal Internet Tax Freedom Act, 47 U.S.C. § 151 note,² which prohibits the imposition of a state sales tax upon the retail sale of telecommunications services to providers of Internet access for use in providing Internet access. The Internet Tax Freedom Act is federal legislation that preempts any Tennessee laws relating to the taxation of Internet access or telecommunications services purchased by Internet access providers.³

1. Prior Law

Prior to the enactment of the Internet Tax Freedom Act, the taxability of Internet access services was governed by the Tennessee sales and use tax laws.

Under the Retailers’ Sales Tax Act, Tenn. Code Ann. § 67-6-101 *et seq.*, the retail sale of tangible personal property and certain services is generally subject to sales and use tax. Tenn.

¹ Currently, the Internet Tax Freedom Act is set to expire on November 1, 2014, pursuant to the amendment of the Act by the Internet Tax Freedom Act Amendments Act of 2007. If the Internet Tax Freedom Act is not extended by Federal legislation beyond that date, Tennessee will resume taxing telecommunications services sold to providers of Internet access for providing Internet access after November 1, 2014.

² Internet Tax Freedom Act (Pub. L. No. 105-277, §§ 1100-1104, 112 Stat. 2681-719 (1998) (set out at note to 47 U.S.C. § 151), amended by Pub. L. No. 107-75, § 2, 115 Stat. 703 (2001), Pub. L. No. 108-435, §§ 2-6, 6A, 118 Stat. 2615 (2004), Pub. L. No. 110-108, §§ 2-6, 121 Stat. 1024 (2007)).

³ The doctrine of preemption stems from the Supremacy Clause, U.S. CONST. art. VI, cl. 2, which gives federal law precedence over a conflicting state law. *See Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516 (1992).

Code Ann. § 67-6-205(c)(3) (2007) imposes the sales tax on the service of furnishing “intrastate, interstate or international telecommunications services.” The term “telecommunications service” is defined under Tenn. Code Ann. § 67-6-102(81)(A) (2007) as the “electronic transmission, conveyance, or routing of voice, data, audio, video, or any other information or signals to a point, or between or among points.” The term includes transmission, conveyance, or routing “in which computer processing applications are used to act on the form, code or protocol of the content for purposes of transmission, conveyance or routing without regard to whether such service is referred to as voice over Internet protocol services or is classified by the Federal Communications Commission as enhanced or value added.” *Id.*

The sale of Internet access services, however, is not subject to sales and use tax. Tenn. Code Ann. § 67-6-102(81)(B)(vi) (2007) specifically excludes Internet access services from the definition of “telecommunications services.” Accordingly, if a taxpayer’s activity could be characterized as the furnishing of a “telecommunications service” as defined under Tenn. Code Ann. § 67-6-102(81)(A), its provision of such services would be subject to the Tennessee sales and use tax. On the other hand, if a taxpayer’s activity were properly characterized as the furnishing of Internet access services, the taxpayer would not be subject to the Tennessee sales and use tax.

In *Prodigy Services Corp., Inc. v. Johnson*, 125 S.W.3d 413 (Tenn.Ct.App. 2003), the Tennessee Court of Appeals considered whether the Internet access services furnished by the taxpayer came within the definition of “telecommunications services” in effect at the time.⁴ The Tennessee Court of Appeals ruled that Internet access services were in fact not subject to the Tennessee sales and use tax as telecommunications. *Id.* at 413. The court noted that the taxpayer relied on telecommunications to provide services to customers, and thus was a “consumer of telecommunications services, not a provider.” *Id.* at 419. As such, the taxpayer’s furnishing of Internet access services to its customers was not subject to sales and use tax as a telecommunication service.

After the *Prodigy* decision, the Department took the position that an Internet access provider was taxable as the end user and consumer of the telecommunications services it purchased in order to provide Internet access.

2. The Internet Tax Freedom Act

The purchase of telecommunications services by the Taxpayer is not subject to the Tennessee sales and use tax because the Internet Tax Freedom Act, 47 U.S.C. § 151 note (the “Act”), prohibits the imposition of a state sales tax upon the retail sale of telecommunications services to providers of Internet access for use in providing Internet access.

Under the Act, retail sales of Internet access services are not subject to Tennessee sales and use tax. Internet Tax Freedom Act § 1101(A)(1), 47 U.S.C. § 151, note. The Act defines that the

⁴ See Tenn. Code Ann. § 67-6-102(31) (2002). Following the *Prodigy* decision, the Tennessee General Assembly enacted Public Chapter 782, Acts of 2004, effective July 1, 2004, which rewrote the sales and use tax provisions pertaining to telecommunications. Public Chapter 499, Acts of 2005, effective June 22, 2005, made further revisions to the telecommunications provisions. As discussed above, the statute now specifically excludes Internet access from the definition of “telecommunications service.”

term “Internet access:”

(A) means a service that enables users to connect to the Internet to access content, information, or other services offered over the Internet;

(B) includes the purchase, use or sale of telecommunications by a provider of a service described in subparagraph (A) to the extent such telecommunications are purchased, used or sold—

(i) to provide such service; or

(ii) to otherwise enable users to access content, information or other services offered over the Internet;

(C) includes services that are incidental to the provision of the service described in subparagraph (A) when furnished to users as part of such service, such as a home page, electronic mail and instant messaging (including voice- and video-capable electronic mail and instant messaging), video clips, and personal electronic storage capacity;

(D) does not include voice, audio or video programming, or other products and services (except services described in subparagraph (A), (B), (C), or (E)) that utilize Internet protocol or any successor protocol and for which there is a charge, regardless of whether such charge is separately stated or aggregated with the charge for services described in subparagraph (A), (B), (C), or (E); and

(E) includes a homepage, electronic mail and instant messaging (including voice- and video-capable electronic mail and instant messaging), video clips, and personal electronic storage capacity, that are provided independently or not packaged with Internet access.

Internet Tax Freedom Act. § 1105(5), 47 U.S.C. § 151, note.⁵

Based on the facts provided, the Taxpayer provides Internet access. Additionally, the Taxpayer purchases telecommunications services in order to provide Internet access to its customers. Because the telecommunications services are purchased by the Taxpayer in conjunction with its provision of Internet access services to its customers, such telecommunications services are considered nontaxable Internet access services under the Act.

⁵ Note that the Internet Tax Freedom Act was amended in 2004 with passage of the Internet Tax Nondiscrimination Act, Pub. L. No. 108-435, 118 Stat. 2615, in which Congress clarified the definition of “Internet access” under the Act to include telecommunications services, “to the extent that such services are purchased, used, or sold by a provider of Internet access to provide Internet access.”

Note as well, that prior to the 2007 amendment to the Act, the Act contained a grandfather clause that allowed states to tax telecommunication service purchased, used or sold by an Internet service provider in certain instances. In general, a tax on telecommunications services that was authorized by statute and generally imposed as of November 1, 2003, was taxable if a provider of Internet access services had a reasonable opportunity to know by virtue of a public rule or other public proclamation that such agency has interpreted and applied such tax to telecommunication services. *See* Internet Tax Freedom Act § 1104(b)(1), 47 U.S.C. § 151 note. Tennessee was able to impose the sales and use tax pursuant to the grandfather clause until its expiration on November 1, 2005. *See* Internet Tax Freedom Act § 1104(b)(2), Pub. L. No. 108-435, §§ 2-6, 6A, 118 Stat. 2615 (2004).

Accordingly, under the Internet Tax Freedom Act, the Taxpayer's purchase of telecommunication services used to provide Internet access services is not subject to Tennessee sales and use tax.⁶

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APPROVED: Reagan Farr
Commissioner of Revenue

DATE: 2/22/08

⁶ See footnote 1.